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BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

Arizona Corporation Commission

DOCKETED

MAR 23 2006

DOCKETED BY	<i>CKR</i>
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IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR PRE-APPROVAL OF
COST RECOVERY FOR PARTICIPATION
IN THE TRANSWESTERN PIPELINE
PHOENIX PROJECT

DOCKET NO. E-01345A-05-0895
DECISION NO. 68597
ORDER

Open Meeting
March 15 and 16, 2006
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS") is engaged in providing electricity service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission ("Commission").

2. On December 16, 2005, APS filed for Commission pre-approval of cost recovery for participation in the Transwestern Pipeline Phoenix natural gas pipeline project ("Phoenix Project"). APS has provided certain information to the Commission pursuant to a confidentiality agreement.

3. The Phoenix Project is a new project which Transwestern would undertake, comprising a combination of some existing pipeline capacity in some segments, and some new construction, including a lateral running down into the Phoenix metro area.

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1 4. APS' filing is pursuant to the Commission's Notice of Inquiry on Natural Gas
2 Infrastructure ("NOI"), which the Commission initiated in April, 2003, to consider issues related to
3 natural gas infrastructure and their impact on natural gas service in Arizona.

4 5. On March 2, 2006, Staff filed its Staff Report in this matter, containing Staff's
5 evaluation and recommendations regarding the APS filing. A confidential and a redacted version
6 of the Staff Report have been put forth.

7 6. Traditionally, Arizona shippers have received virtually all of their interstate
8 pipeline service on the El Paso Natural Gas Company ("El Paso") pipeline system, comprising a
9 northern system, a southern system, and a number of laterals. A small amount of northern Arizona
10 demand is serviced via the existing Transwestern and Southern Trails pipelines, but El Paso has a
11 monopoly on natural gas service in central and southern Arizona, including the Phoenix metro
12 area.

13 7. Service on El Paso has undergone a great deal of change and uncertainty in recent
14 years and such change is likely to continue in the near future as FERC considers El Paso's current
15 rate proceeding and other matters. Issues of debate in recent years on the El Paso system include
16 the allocation of delivery rights at Topock, elimination of full requirements rights for large East-
17 of-California shippers, California's pursuit of market manipulation allegations against El Paso and
18 others, implementation of Order 637 provisions on the El Paso system, and a host of issues being
19 addressed in the current El Paso rate proceeding at FERC.

20 8. A fundamental difference in circumstances between California and Arizona
21 shippers is that California shippers have a variety supply options beyond El Paso, while Arizona
22 shippers, including APS, generally do not have such options. Such an advantageous position for
23 California has resulted in California shippers being able to negotiate discounted rates with El Paso,
24 with Arizona shippers, including APS, likely to be looked upon to pay for such discounts.

25 9. Introduction of some level of pipeline competition into central Arizona, via a
26 project such as the proposed Transwestern Phoenix Project, would diversify Arizona's natural gas
27 infrastructure, would provide Phoenix area shippers with a competitive option, would provide
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1 additional access to cheaper San Juan gas, could lead to creation of a market center for natural gas
2 pricing in Arizona.

3 10. The Staff Report discusses a variety of issues including the details of the proposed
4 Phoenix lateral, background information, Arizona's competitive position in the Southwestern
5 natural gas market, the impact of the proposed project on Arizona natural gas supplies,
6 implications of El Paso's current rate proceeding before FERC, reliability issues, the agreement
7 between APS and Transwestern, a cost analysis of Transwestern service to APS, cost recovery for
8 APS, right-of-way and construction issues in Arizona, comments and filing by parties, APS'
9 application in the broader scope of the Transwestern project, the Commission's NOI and its
10 relationship to APS' application, what pre-approval means, the impact of pre-approval on APS'
11 level of risk, and Staff's conclusions and recommendations. Several appendices are attached to the
12 Staff Report, discussing the siting process for an interstate pipeline in Arizona and providing a
13 sensitivity analysis regarding the cost of Transwestern service to APS.

14 11. In response to the serious issues facing Arizona's natural gas service both now and
15 in the future, the Commission initiated the NOI in April 2003. Through the NOI, the Commission
16 has conducted several workshops and has received a good deal of input at a number of points in
17 the process from a variety of interested parties.

18 12. On December 18, 2003, the Commission issued its Policy Statement Regarding
19 New Natural Gas Pipeline and Storage Costs. This policy statement addressed a number of issues
20 including supply/infrastructure diversity, supply/infrastructure planning, the Commission's
21 approach to new infrastructure projects, the general Commission approach, individual utility
22 circumstances, and reporting. The policy statement also indicated that the traditional method of
23 utilities participating in infrastructure projects and then later having the Commission review such
24 participation is the preferred method, but given Arizona's natural gas infrastructure circumstances,
25 the Commission would consider applications for alternate cost recovery treatment, including pre-
26 approval.

27 13. APS' filing addresses many of the topics which the Commission's December 18,
28 2003, Policy Statement Regarding New Natural Gas Pipeline and Storage Costs identifies.

1 14. APS' application requests pre-approval of specific costs related to the Transwestern
2 capacity, including the reservation charge, volumetric rate, fuel rate, and applicable surcharges.

3 15. On December 14, 2005, APS entered into the Phoenix Project expansion agreement
4 with Transwestern. The currently projected timeline for the Transwestern project is that
5 Transwestern would file for FERC in August 2006, begin construction in July 2007, and
6 commence operations in April 2008.

7 16. The precedent agreement contains a variety of termination rights for both APS and
8 Transwestern, which either party can exercise at various points in the process.

9 17. Inherently any assessment of the relative merits of a new pipeline into central
10 Arizona is difficult due to a variety of uncertainties regarding future costs and operational
11 conditions on the El Paso system, future commodity costs, cost differentials between supply
12 basins, and other factors, some of which are not easily quantified, including the benefits of pipe-
13 on-pipe competition.

14 18. APS has estimated that acquisition of the Transwestern capacity, in comparison to
15 taking service from El Paso, would result in additional costs of approximately \$2 million, or 0.66
16 percent, in 2009, and approximately \$1.1 million, or 0.37 percent, in 2015. Such estimates are
17 based upon a number of assumptions, including an assumed differential of \$0.10 per decatherm
18 between the San Juan and Permian basins. Variations in the assumptions could change the
19 comparative costs, possibly making the total gas supply cost from taking service from
20 Transwestern less than the total gas supply cost from taking service from El Paso.

21 19. Using APS' base case projections, the additional cost of taking service from
22 Transwestern would result in a customer impact on a average E-12 residential customer of
23 approximately \$0.58 annually, or less than five cents per month.

24 20. The Commission has previously pre-approved recovery of costs for pipeline
25 capacity on a new pipeline in Arizona for APS and Southwest Gas on the previously proposed
26 Kinder Morgan Silver Canyon pipeline, a project which was eventually discontinued.

27 21. Acquisition of capacity on the proposed Phoenix Project by APS would play a
28 significant role in moving the proposed project forward.

1 22. The Staff Report contains the following proposed conditions:

- 2 • The Commission retains full authority to review APS' gas procurement
3 activities, including its management of all pipeline capacity and related
4 activities, recognizing that the Commission is pre-approving the underlying
5 acquisition of the Transwestern capacity during the initial 15-year term of the
6 agreement with Transwestern. The pre-approval being granted in this
7 proceeding would expire upon completion of the initial 15-year term.
- 8 • The impact, if any, on APS' risk profile resulting from pre-approval of costs
9 related to Transwestern Phoenix Project capacity would be considered within
10 the context of future APS rate proceedings.
- 11 • APS shall file a status report on the Transwestern Phoenix Project and APS'
12 participation in the project with the Commission every six months until either
13 APS begins taking service from Transwestern or APS' participation in the
14 project is terminated.
- 15 • APS shall notify the Commission, within ten day of when the exact volumetric
16 and fuel rates, applicable for APS when APS begins service with Transwestern,
17 are set for the Transwestern pipeline.
- 18 • APS shall notify the Commission within ten days of each of the following
19 events regarding the Transwestern project: a) Transwestern filing with FERC
20 for approval of the Phoenix Project, b) FERC granting approval of the Phoenix
21 Project, c) Transwestern beginning construction of the Phoenix Project, d)
22 Transwestern completing construction of the Phoenix Project, and e) APS
23 beginning to take service from the Transwestern Phoenix Project.
- 24 • APS shall notify the Commission if at any time either APS or Transwestern
25 exercises termination rights pursuant to the precedent agreement or if any other
26 events significantly impact APS' participation in the Transwestern Phoenix
27 Project, within ten days of any such action.
- 28 • Pre-approval of the specific costs related to APS' acquisition of capacity on the
Transwestern Phoenix Project is granted based upon the specific and unique
conditions considered in this application and will in no way commit or
predispose the Commission regarding any future considerations of pre-approval
of costs. Rather, the standing presumption would be that the Commission
would not grant pre-approval in future proceedings, absent a careful
consideration of unique, serious, and important circumstances which would
require such action.
- None of the pre-approved costs will be passed on to APS' ratepayers until all of
the following occur:

- The Transwestern Phoenix Project is built and operational.
- APS is receiving service on the Transwestern project consistent with the precedent agreement and this order.

23. On January 9, 2006, Transwestern filed comments in this proceeding, supporting APS' application.

24. On January 13, 2006, El Paso filed for intervention in this proceeding. On January 26, 2006, El Paso was granted intervention in this proceeding.

25. Staff believes that APS' participation in the Phoenix Project is reasonable given information available at this time.

26. Staff has recommended that the Commission pre-approve recovery of APS' reservation specific costs related to the Transwestern capacity at issue in this proceeding, including the reservation charge, volumetric rate, fuel rate, and applicable surcharges, subject to certain conditions.

CONCLUSIONS OF LAW

1. APS is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over APS and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated March 2, 2006, concludes that it is in the public interest to approve the request for pre-approval of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern capacity at issue in this proceeding.

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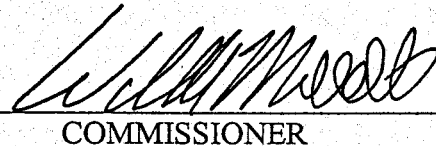
ORDER

IT IS THEREFORE ORDERED that APS' recovery of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern pipeline capacity at issue in this proceeding be and hereby is pre-approved for cost recovery, as discussed herein.

IT IS FURTHER ORDERED that this Order shall be effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION


CHAIRMAN

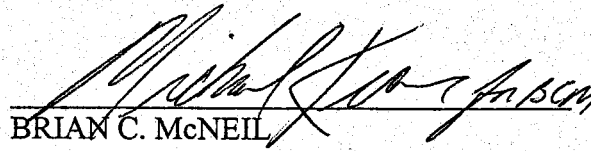

COMMISSIONER


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COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 23rd day of March, 2006.


BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:RGG:lhmk/L

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